Supreme Court, U.S.
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No. 95-790

In The

Supreme Court of the United States

October Term, 1995

SOUTHMARK CORPORATION

Petitioner,

vs.

D. VINSON MARLEY

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

JENKENS & GILCHRIST,
A Professional Corporation

GREGORY G. HESSE
State Bar No. 09549419

1445 Ross Avenue, Suite 3200
Dallas, Texas 75202-2799
Telephone: (214) 855-4500
Facsimile: (214) 855-4300

Attorneys for Petitioner, Southmark Corporation

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

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QUESTIONS PRESENTED

1. Should this Court grant certiorari to review the decision of the Fifth Circuit that for purposes of a preference cause of action in a bankruptcy case under 11 U.S.C. § 547(b) the debt arising from an executory contract is incurred on the date a payment comes due under the executory contract rather than the date when the executory contract was executed?

2. Should this court grant certiorari to review the decision of the United States Court of Appeals for the Fifth Circuit (the "Fifth Circuit") that for purposes of a preference cause of action under 11 U.S.C. § 547(b) in a bankruptcy case that a transfer pursuant to a check is effective as of the date the check is delivered to the creditor rather than the date the check is honored by the payor bank?

LIST OF PARENT CORPORATIONS AND SUBSIDIARIES FOR SOUTHMARK CORPORATION AS REQUIRED BY SUPREME COURT RULES 14.1(b) AND 29.6

Parent Corporations:

None

Subsidiary Corporations:

Care Centers, Inc.
Dominion Subsidiary Co.
Envicon Development Corp.
HCW Gas Processors, Inc.
Johnstown American Subsidiary Corporation, No. 3
Johnstown Investment Corp.
Monument Investments, Inc.
Riviera Utilities of Arkansas, Inc.
Southmark Acquisitions, Inc.
Southmark Acquisitions Canada LTD.
Southmark Commercial Management, Inc.
Southmark Financial Services, Inc.
Southmark Hospitality Management, Inc.
Southmark International, NV
Southmark Investment Group, Inc.
Southmark Life Group, Inc.
Southmark Life Subsidiary Corp.
Life Group Associates II, Inc.
Robert A. McNeil Corp.
Pacific Income Plan Company of California
Pacific Investors Corp.
Southmark PS, Inc.
Southmark San Juan, Inc.
Southmark/Security National Investment Corp.
First Associated Management, Inc.
Southmark Tek, Inc.
North American Mortgage Investors
First HCW Pension Real Estate, Inc.
Southmark Investors, Inc.

LIST OF PARENT CORPORATIONS AND SUBSIDIARIES FOR SOUTHMARK CORPORATION AS REQUIRED BY SUPREME COURT RULES 14.1(b) AND 29.6 – Continued

Southmark Management Corp.
University Advisory Company, Inc.
SPC Holding Co.
Devam Corp.
Southmark Pacific Corp.
Pennpacific Properties, Inc.
Sopac Development Co.
West Texas Working Interest Corp.

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PETITION FOR WRIT OF CERTIORARI

Petitioner, Southmark Corporation ("Southmark"), respectfully prays that this Court issue a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit (the "Fifth Circuit") entered on June 26, 1995 and the subsequent denial of two Petitions for Rehearing entered on August 8, 1995 and August 30, 1995.

OPINIONS BELOW

The United States Bankruptcy Court for the Northern District of Texas (the "Bankruptcy Court") entered a judgment in favor of D. Vinson Marley ("Marley") and against Southmark because of the Bankruptcy Court's conclusion that: (i) the property transferred from Southmark to Marley was not property in which Southmark owned an interest as required by 11 U.S.C. § 547(b); (ii) the earmarking doctrine applied and, as a consequence, Southmark merely substituted one creditor for another; and (iii) the transfer from Southmark to Marley was not on account of an antecedent debt as required by 11 U.S.C. § 547(b)(2). On July 25, 1994, the United States District Court for the Northern District of Texas (the "District Court") affirmed the Bankruptcy Court's decision. On June 26, 1995, the Fifth Circuit affirmed the lower courts and held that the transfer from Southmark to Marley was not avoidable as a preference because it was protected by the contemporaneous exchange for new value defense of 11 U.S.C. § 547(c)(1). *See, Southmark Corporation v. Marley (In the Matter of Southmark Corporation)*, 55 F.3d 1071 (5th

Cir. 1995) (the "First Opinion"). While the Fifth Circuit denied Southmark's first Petition for Rehearing on August 8, 1995, it vacated its First Opinion, but affirmed the lower courts by holding that for purposes of 11 U.S.C. § 547(b)(2), (i) the debt arising from an executory contract arises when the payment becomes due; (ii) a transfer by check occurs when the check is delivered to the creditor; and (iii) as a consequence, the transfer from Southmark to Marley occurred simultaneously with the incurrence of the debt. *See, Southmark Corporation v. Marley (In re Southmark Corporation)*, 62 F.3d 104 (5th Cir. 1995) (the "Second Opinion") (this case shall be hereinafter referred to as "*Southmark v. Marley*"). On August 30, 1995, the Fifth Circuit denied Southmark's second Petition for Rehearing.

JURISDICTION

The Fifth Circuit entered its First Opinion on June 26, 1995, entered its Second Opinion denying the first Petition for Rehearing on August 8, 1995, and entered its order denying the second Petition for Rehearing on August 30, 1995. This Court's jurisdiction to consider this petition for writ of certiorari from the final judgment of the United States Court of Appeals for the Fifth Circuit is invoked pursuant to 28 U.S.C. § 1254.

STATUTORY PROVISIONS

The relevant statute is 11 U.S.C. § 547(b), which provides:

> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property –
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;
>
> (4) made –
>
> (A) on or within 90 days before the date of the filing of the petition; or
>
> (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
>
> (5) that enables such creditor to receive more than such creditor would receive if –
>
> (A) the case were a case under chapter 7 of this title;
>
> (B) the transfer had not been made; and
>
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

STATEMENT OF THE CASE

Prior to Southmark filing its bankruptcy petition, Marley was employed as Senior Executive Vice President of Southmark pursuant to an Employment Agreement dated August 16, 1982. Paragraph 10 of the Employment Agreement gave Southmark the right to terminate Marley's employment at any time, but if Southmark exercised its right under paragraph 10, the Employment Agreement required Southmark to pay severance benefits to Marley. In mid April, 1989, Marley's employment was terminated by Southmark. On April 28, 1989, Marley and Southmark entered into a letter agreement (the "Settlement Agreement") pursuant to which Marley released Southmark from all obligations under the Employment Agreement. On the same day, April 28, 1989, Marley received a check in the amount of $400,000 (the "Transfer") in full satisfaction of Southmark's remaining obligations under the Employment Agreement ($357,000) and as a prepayment for consulting services from April 30, 1989 through July 31, 1989 ($43,000). The check was paid by San Jacinto Savings Association ("San Jacinto") on May 4, 1989 (the "Transfer Date").

Subsequently, on July 14, 1989 (the "Petition Date"), Southmark filed its voluntary petition for relief under Chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code"), such Bankruptcy Case was styled *In re Southmark Corporation*, Bankruptcy Case No. 3-89-36324-SAF-11. On July 11, 1991, Southmark initiated an adversary proceeding in the Bankruptcy Court styled *Southmark Corporation v. D. Vinson Marley*, Adversary Proceeding No. 391-3365 (the "Adversary Proceeding"), to recover the Transfer as a preference and/or fraudulent

transfer. The Bankruptcy Court had jurisdiction over the Adversary Proceeding pursuant to 28 U.S.C. § 1334 and the Adversary Proceeding was a "core proceeding" within the meaning of 28 U.S.C. § 157(b)(2)(F).

REASONS FOR GRANTING THE WRIT

A. Issue One

The Fifth Circuit has decided that the debt relating to an executory contract arises on the date the payment is due under the executory contract rather than on the date the executory contract is executed. The decision of the Fifth Circuit is in direct conflict with applicable authority from the United States Court of Appeals for the Eighth Circuit (the "Eighth Circuit"), the United States Court of Appeals for the Fourth Circuit (the "Fourth Circuit") and the United States Court of Appeals for the Ninth Circuit (the "Ninth Circuit"), each of which has held that the debt relating to an executory contract arises on the date the contract is executed.

In *United States acting through the Agricultural Stabilization and Conservation Service v. Gerth*, 991 F.2d 1428 (8th Cir. 1993)(hereinafter referred to as "*Gerth*"), Gerth entered into two separate Conservation Reserve Program ("CRP") contracts with the Agricultural Stabilization and Conservation Service ("ASCS") dated August 27, 1987 and July 7, 1989. Under the CRP contracts, Gerth agreed to withhold certain land from production, establish a vegetative cover to prevent erosion, maintain the cover and file certain forms each year. If Gerth complied with his obligations under the CRP Contract, ASCS agreed to

make payments to Gerth. The payments from ASCS were to be made annually and were contingent on Congress appropriating money to fulfill the ASCS obligations under the CRP contracts. Indeed, if Congress chose not to appropriate money for the CRP contracts, ASCS had no obligation to make the payments to Gerth. *Gerth*, 991 F.2d at 1430 and 1433.

On January 1, 1991, Gerth filed for bankruptcy and ASCS filed a proof of claim alleging that Gerth was indebted to ASCS for agricultural price support overpayments from 1988 to 1989. ASCS filed a motion for relief from the automatic stay with the bankruptcy court alleging that the pre-petition claim was subject to setoff against any future payments it may owe to Gerth under the CRP contract. Gerth disagreed and argued to the court that post-petition debts owing by ASCS to Gerth could not be used to offset pre-petition debts owing by Gerth to ASCS because the debts lacked mutuality. Therefore, the issue before the court was whether the debt of ASCS on an executory contract to make future payments to Gerth was a pre-petition debt that arose when the CRP contract was executed or post-petition debt that arose when all the contingencies for payment had been fulfilled. *Gerth*, 991 F.2d at 1431.

Gerth argued that the debt of ASCS to make future payments was contingent on Congress appropriating funds for payment and, as a consequence was a post-petition debt that arose when all contingencies for payment had been fulfilled. *Gerth*, 991 F.2d at 1433. The Eighth Circuited disagreed:

> " . . . dependency on a post-petition event does not prevent a debt from arising pre-petition. 'The character of a claim is not transformed from pre-petition to post-petition simply because it is contingent, unliquidated or unmatured when the debtor's petition is filed.' *Braniff Airways, Inc. [v. Exxon Co. U.S.A.]*, 814 F.2d [1030] 1036 [5th Cir. 1987] (quoting *Stair v. Hamilton Bank of Morristown (In re Morristown Lincoln-Mercury, Inc.)*, 42 B.R. 413, 418-19 (Bankr. E.D. Tenn. 1984)). A debt can be absolutely owing pre-petition even though that debt would never have come into existence except for post-petition events. *See Sherman v. First City Bank of Dallas (In re United Sciences of America, Inc.)*, 893 F.2d 720, 724 (5th Cir. 1990).
>
> In this case, Gerth's claim – his right to payment – came into existence at the time the contract was signed and the ASCS promised to pay him. That claim is contingent on Congress appropriating the necessary funds each year. Because a contingency does not change when a claim arises, Congress' appropriation of the funds is not a necessary transaction for ASCS's liability to arise."

Gerth, 991 F.2d at 1433-1434. In *Gerth*, the Eighth Circuit held that a debt from an executory contract arises when the agreement is executed, even if the payment is contingent upon an event that occurs subsequent to the execution of the executory contract. *Gerth*, 991 F.2d at 1434. *See also, Stewart Foods, Inc. v. Broecher (In re Stewart Foods, Inc.)*, 64 F.3d 141, 146 (4th Cir. 1995)(citing *Chiasson v. J. Louis Matherne & Associates (In re Oxford Management, Inc.)*, 4 F.3d 1329, 1335 n. 7 (5th Cir. 1993)("A claim is not rendered a post-petition claim simply by the fact that

time for payment is triggered by an event that happens after the filing of the petition."); *Gerth*, 991 F.2d at 1433; and *Braniff Airways*, 814 F.2d at 1036).

The Court in *In re Upstairs Gallery, Inc.*, 167 B.R. 915 (9th Cir. BAP 1994) (hereinafter referred to as "*Upstairs Gallery*") reached the same conclusion as the Fourth Circuit in *Stewart Foods* and the Eighth Circuit in *Gerth*. The fact pattern in *Upstairs Gallery* is almost identical to the fact pattern faced by the Fifth Circuit in Marley.[1] On April 28, 1988, the debtor in the *Upstairs Gallery* case entered into a lease agreement with its landlord and the lease provided for the debtor to make monthly rental payments to the landlord. Prior to filing for bankruptcy, the debtor terminated the lease and, on November 20, 1990, the debtor and landlord entered into a settlement agreement pursuant to which the debtor paid the sum of $38,532.36 to the landlord pursuant to a check delivered on November 20, 1990, in satisfaction of all remaining obligations under the lease. *Upstairs Gallery*, 167 B.R. at 917.

The issue addressed by the court in *Upstairs Gallery* was whether the transfer from the debtor to the landlord was on account of an antecedent debt as required by 11 U.S.C. § 547(b)(2). 167 B.R. at 917. The *Upstairs Gallery* Court acknowledged that the term "antecedent debt" is not defined in the Bankruptcy Code and reasoned that

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[1] The Ninth Circuit Bankruptcy Appellate Panel is an adjunct of the United States Court of Appeals for the Ninth Circuit and its decisions are binding on all lower courts in the circuit. *See, e.g. In re Globe Illumination Co.*, 149 B.R. 614, 620-621 (Bankr. C.D. Cal. 1993).

whether a debt is antecedent or current depends upon when it is incurred. 167 B.R. at 917-918. The court further reasoned that a debt is incurred when the debtor first becomes legally obligated to pay. *Upstairs Gallery*, 167 B.R. at 918. *See also Southmark v. Marley*, 62 F.2d at 106. The *Upstairs Gallery* court distinguished between periodic payments under an executory contract and a payment to settle a terminated executory contract. The *Upstairs Gallery* court observed that the debt for monthly rent was in fact a debt for occupancy of property and, as a consequence, was incurred on a periodic basis. *Upstairs Gallery*, 167 B.R. at 918. Since the transfer from the debtor to the landlord was made to satisfy the remaining obligations under the terminated lease, the *Upstairs Gallery* court held that the debt arose for purposes of 11 U.S.C. § 547(b)(2) on the date the lease was executed (*i.e.* April 29, 1988) rather than the subsequent termination and settlement date (*i.e.* November 20, 1990). *Upstairs Gallery*, 167 B.R. at 918.

The decision by the Fifth Circuit in *Marley* is in direct conflict with the decisions of the Eighth Circuit in *Gerth*, the Fourth Circuit in *Stewart Foods* and the Ninth Circuit in *Upstairs Gallery*. In *Marley*, Southmark and Marley executed the Employment Agreement on August 16, 1982. In paragraph 10 of the Employment Agreement, Marley gave Southmark the right to terminate his employment. However, if Southmark executed its right to terminate Marley's employment, Southmark had to satisfy severance obligations to Marley. In 1989, Southmark executed its right under paragraph 10 of the Employment Agreement and terminated Marley's employment. Further, in 1989, Southmark paid $357,000 to Marley as required by

paragraph 10 to settle all remaining obligations under the Employment Agreement. *Southmark v. Marley*, 62 F.3d 104, 105 (5th Cir. 1995). If the Court were to follow the analysis of the Fourth Circuit, Eighth Circuit or Ninth Circuit, the Court would hold that the debt arose on April 16, 1982. *See Gerth*, 991 F.2d at 1433; *Stewart Foods*, 64 F.3d at 146; and *Upstairs Gallery*, 167 B.R. at 918. However, the Fifth Circuit held that the transfer from Southmark to Marley satisfied an obligation that arose in 1989. *Southmark Corporation v. Marley*, 62 F.3d at 106.

Therefore, this Court should review the decision of the Fifth Circuit to resolve the conflict between the Fifth Circuit on the one hand and the Fourth Circuit, Eighth Circuit and Ninth Circuit, on the other hand, and determine the date a debt arises under an executory contract is the date the executory contract is executed.

B. Issue Two

The Fifth Circuit has decided that a transfer to satisfy a debt, which transfer is pursuant to a check (i) delivered to the creditor on the same day the debt is incurred, (ii) negotiated in the ordinary course of business and (iii) honored by the payor bank within six days, is a "simultaneous transfer" rather than a transfer on account of an antecedent debt. The basis for the Fifth Circuit's decision is that the date of delivery rule for a check is applicable under 11 U.S.C. § 547(b)(2). Therefore, the decision of the Fifth Circuit is in conflict with applicable authority of this court, *see Barnhill v. Johnson*, 503 U.S. 393, 112 S.Ct. 1386, 118 L.Ed.2d 39 (1992), and in conflict with the global

structure and purpose of the Bankruptcy Code. *See*, 11 U.S.C. § 547(c)(1).

1. The Fifth Circuit's Decision is in Conflict with *Barnhill*

In *Barnhill*, the debtor made a payment to Barnhill, the petitioning creditor, to satisfy a debt owing to Barnhill. The check was delivered on November 18, but was not honored by the drawee bank until November 20. The specific issue before the court was the date of the transfer for purposes of 11 U.S.C. § 547(b). The court wrestled with the argument of the petitioning creditor that delivery of the check is a "conditional transfer" and once the check is honored in the ordinary course of business, the payment relates back to the date the check was delivered. *Barnhill*, 112 S.Ct. at 1390-91. In dismissing the petitioning creditor's argument, the court sketched the rights and duties under state law for a check transaction but concluded that federal law controls the date a transfer occurs and a transfer pursuant to a check occurs on the date the bank honors the check. *Barnhill v. Johnson*, 112 S. Ct. at 1389-90. The Fifth Circuit in *Southmark v. Marley* held that a transfer pursuant to a check delivered on the same day a debt is incurred but not paid for six days is a "simultaneous transfer." Notwithstanding the Fifth Circuit's protestations to the contrary, its decision is contrary to this Court's decision in *Barnhill*.

In order to justify its decision, the Fifth Circuit applied state law to determine the impact of delivery of a check on a debt. The Fifth Circuit reasoned that pursuant to Uniform Commercial Code § 3-802(1)(b) (hereinafter

"UCC"), the delivery of a check "suspends" an obligation until the check is honored by the paying bank. *Southmark v. Marley*, 62 F.3d at 107. *See also*, Official Comment, ¶ 3, Tex. Bus. & Com. Code ann. § 3.802 (Tex. U.C.C. 1994). Under the UCC, if the bank pays the check, payment is deemed to have occurred on the date the check is delivered and the obligation is discharged. *Lakeway Co. v. Bravo*, 576 S.W.2d 926, 929 (Tex. Civ. App. – Tyler 1979, writ ref'd n.r.e.); *Moore v. Travellers Indemnity Insurance Company*, 408 A.2d 298, 301 (Del. Super. Ct. 1979). Because of the workings of the UCC, the Fifth Circuit held that the transfer date for purposes of 11 U.S.C. § 547(b)(2) would be the date the check was delivered rather than honored. *Southmark v. Marley*, 62 F.3d at 107.

In order to harmonize its decision with this Court's decision in *Barnhill*, the Fifth Circuit held that the date of honor rule espoused in *Barnhill* is limited solely to an analysis of whether the transfer was made within 90 days of the petition date as required by 11 U.S.C. § 547(b)(4). *Southmark v. Marley*, 62 F.3d at 107. Unfortunately, the analysis of *Barnhill* by the Fifth Circuit is disingenuous because this court held in *Barnhill* that the date of honor rule applies to all subsections of 11 U.S.C. § 547(b). *Barnhill* 112 S.Ct. at 1391. Therefore, this Court should issue a writ of certiorari to review the decision of the Fifth Circuit and determine whether a transfer pursuant to a check is effective on the date the check is delivered.

2. The Fifth Circuit's Decision Results in a Windfall for Transferees

The Fifth Circuit argues that if the date of honor rule applies to 11 U.S.C. § 547(b)(2), creditors may receive a windfall at the expense of the transferee. *Southmark v. Marley*, 62 F.3d at 107, n.3. The concerns of the Fifth Circuit about a potential windfall to other creditors is misplaced and a review of the whole Bankruptcy Code reveals and explains why the concern is non-existent.

When Congress enacted the Bankruptcy Code, it struck a balance between the potential windfalls by both pre-petition transferees and the bankruptcy estate. To prevent pre-petition transferees from receiving windfalls, Congress enabled a trustee to recover preferential and fraudulent transfers. *See* 11 U.S.C. §§ 547 and 548. Indeed, when the Bankruptcy Court found, as was required by 11 U.S.C. § 547(b)(5), that Marley received more from the transfer (*i.e.* 100% of his claim) than he would have received in the bankruptcy case, the Bankruptcy Court implicitly found Marley may have received a windfall at the expense of other creditors who did not receive payment in full. An additional provision that prevents recipients of preferential or fraudulent transfers from receiving a windfall is 11 U.S.C. § 502(d), which allows the court to disallow the claim of such a recipient and prevent such a recipient from receiving a distribution from the estate when the recipient previously returned such transfer.

But not all of the provisions of the Bankruptcy Code benefit the bankruptcy estate. Congress also enacted provisions to prevent the estate from receiving a windfall at

the expense of pre-petition transferees. For example, several of the defenses in 11 U.S.C. § 547(c) prevent the trustee from recovering a preference if the transferee has replenished the estate with new value. For example, the contemporary exchange for new value defense of 11 U.S.C. § 547(c)(1) prevents the recovery of a preference if the preference was given in exchange for new value. *See, In the Matter of Fuel Oil Supply & Terminaling, Inc.*, 837 F.2d 224, 228 (5th Cir. 1988). Even if the preferential transferee has not given new value to the estate, Congress enacted 11 U.S.C. § 502(h) to prevent the estate from receiving a windfall at the expense of the pre-petition transferee. Under 11 U.S.C. § 502(h), the preferential transferee has a claim in the amount of the transfer he returns to the estate and he is entitled to receive pro rata distributions from the estate along with all other similarly situated creditors.

Since Congress already balanced the equities between the estate and pre-petition transferees to prevent "windfalls" to each, the concerns of the Fifth Circuit are unfounded. Therefore, this Court should not allow the Fifth Circuit to create new exceptions to the trustee's power to recover preferences in the form of artificial "simultaneous transfers," which would throw the compromises of Congress out of balance.

3. The Fifth Circuit's Decision Renders 11 U.S.C. § 547(c) Meaningless

A proper evaluation of all of 11 U.S.C. § 547 reveals that payment by check is a preferential transfer. This Court has advised that statutory construction is a holistic

endeavor. *United Savings Association of Texas v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 108 S.Ct. 626, 630, 98 L.Ed.2d 740 (1988). Indeed, a provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme. *Id.* This Court has further cautioned lower courts not to interpret one statute in such a manner as to render another statute superfluous. *Connecticut National Bank v. German*, 503 U.S. 249, 112 S.Ct. 1146, 1150, 117 L.Ed.2d. 39 (1992) (O'Connor J., concurring); *United States v. Menasche*, 348 U.S. 528, 75 S.Ct. 513, 519-520, 99 L.Ed. 615 (1955). Therefore, when interpreting the term "antecedent debt" for purposes of avoiding a preference, the Court should look to all of 11 U.S.C. § 547.

A debt is antecedent under 11 U.S.C. § 547(b) if the debtor incurs the debt prior to making the alleged preferential transfer. *In re Intercontinental Publications*, 131 B.R. 544, 549 (Bankr. D. Conn. 1991), *Tidwell v. AmSouth Bank, (In re Cavalier Homes)*, 102 B.R. 878, 885 (Bankr. M.D. Ga. 1989). Therefore, the Fifth Circuit properly addressed its focus on the date Southmark incurred the debt to Marley and the date the Transfer occurred. *Southmark v. Marley*, 62 F.3d at 106. The Fifth Circuit held that Southmark incurred the debt to Marley on April 28, 1989 and that the Transfer to Marley occurred on May 4, 1989 when San Jacinto paid the check. *Southmark v. Marley*, 62 F.3d at 107. Notwithstanding its determination that Southmark incurred the debt six days before the Transfer occurred, the Fifth Circuit held that the transfer was on account of a "simultaneous debt" not an "antecedent debt". The Fifth Circuit's ruling is a faulty interpretation of 11 U.S.C. § 547.

When Congress redrafted the preferential transfer section of the Bankruptcy Code in 1978, it crafted 11 U.S.C. § 547(b) in such a manner that a purchase of goods, services or a release with a check would be a credit transaction, and, as a result, the payment by the bank of the check is a preferential transfer within the meaning of 11 U.S.C. § 547(b). *See*, H.R. Rep. No. 595, 95th Cong. 1st Sess. 373 (1977) ("a check is a credit transaction"); S. Rep. 989, 95th Cong., 2nd Sess. 88 (1978) ("a check is a credit transaction"). Indeed, the legislative history complies with many commercial cases holding that a check is not a payment but a promise of a future payment when (or if) the check clears. *Krantz v. Holt*, 819 P.2d 352, 355 (Utah 1991); *Estate of Kohlhepp v. Mason*, 478 P.2d 339, 342 (Utah 1970); *Kensil v. City of Ocean City*, 215 A.2d 43, 46 (N.J. 1965); J. White & R. Summers, *Uniform Commercial Code*, p. 541 (2nd ed. 1980). On the surface, the decision by Congress to draft 11 U.S.C. § 547(b) in this manner may seem harsh. However, the result is required to prevent depletion of the estate by zealous creditors and to promote equality of distribution to creditors.

To temper the effects of 11 U.S.C. § 547(b) and to promote creditors to continue conducting business with financially distressed entities, Congress enacted several exceptions to a trustee's ability to avoid transfers. One such exception is the contemporaneous exchange for new value defense of 11 U.S.C. § 547(c)(1), which provides:

> "(c) The trustee may not avoid under this section a transfer –

> (1) to the extent that such transfer was
>
> (A) intended by the debtor and creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
>
> (B) in fact a substantially contemporaneous exchange."

To come within the exception of 11 U.S.C. § 547(c)(1), a creditor must prove three elements: (i) that the creditor extended new value to the debtor; (ii) both the creditor and the debtor intended the new value and the reciprocal transfer to be contemporaneous; and (iii) the exchange must in fact be contemporaneous. *Cimmaron Oil Company, Inc. v. Cameron Consultants, Inc.*, 71 B.R. 1005, 1008 (N.D. Tex. 1987). *See also, O'Rourke v. Coral Construction, Inc. (In re E.R. Fegert, Inc.)*, 88 B.R. 258, 259 (9th Cir. BAP 1988), *aff'd* 887 F.2d 955 (9th Cir. 1989); *Creditors Committee v. Spada (In re Spada)*, 903 F.2d 971, 975 (3rd Cir. 1990); *Tyler v. Swiss American Securities, Inc. (In re Lewellyn and Company, Inc.)*, 929 F.2d 424, 427 (8th Cir. 1991). The specific purpose of the contemporaneous exchange for new value defense is to protect a purchase of goods or services made with a check. H.R. Rep. No. 595, 95th Cong. 1st Sess. 373 (1977).[2] The rationale of the contemporaneous exchange for new value defense is that a transfer in exchange for

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[2] "[F]or purposes of this paragraph (*i.e.* 11 U.S.C. § 547(c)(1)], a transfer involving a check is considered to be 'intended to be contemporaneous,' and if the check is presented for payment in the normal course of affairs . . . that will amount to a transfer that is 'in fact substantially contemporaneous.'" H.R. Rep. No. 595, 95th Cong. 1st Sess. 373 (1977).

new value does not deplete the estate to the detriment of other creditors. *Fuel Oil Supply*, 837 F.2d at 229.

In its ruling, the Fifth Circuit rendered 11 U.S.C. § 547(c)(1) superfluous because it held a transfer made on May 4 to satisfy a debt incurred on April 28 is a simultaneous transfer. If the Court's interpretation of 11 U.S.C. § 547(b)(2) is correct, 11 U.S.C. § 547(c)(1) would never be applicable, a result at odds with general rules of statutory construction. The only interpretation of 11 U.S.C. § 547(b)(2) that does not render 11 U.S.C. § 547(c)(1) meaningless is to hold as a preference all transfers pursuant to a check tendered, but not paid, on the same day that goods or services are delivered to the debtor. Then, only if the elements of the contemporaneous exchange for new value defense, as codified in 11 U.S.C. § 547(c)(1), have been satisfied, will the preferential transfer not be avoidable.

In this case, the Transfer was made on May 4 to satisfy a debt incurred on April 28. The Transfer was on account of an antecedent debt. Marley, however, can not avail himself of the contemporaneous exchange defense of 11 U.S.C. § 547(c)(1) because he did not provide new value to Southmark as that term has been defined in 11 U.S.C. § 547(a)(2). Indeed, in this case, the transaction which resulted in the release provided by Marley to Southmark resulted in a diminution of the assets available to pay all creditors of Southmark. *See, Fuel Oil Supply*, 837 F.2d at 229. Because the Fifth Circuit improperly held that the Transfer was not on account of an antecedent debt, this Court should grant Southmark's Petition Writ of Certiorari to review the decision of the Fifth Circuit and determine whether a transfer is preferential if

it is made by check delivered to the creditor the same day the debt arises but not paid until six days later.

CONCLUSION

For all the reasons stated, Petitioner, Southmark Corporation, prays that this Court grant a Writ of Certiorari to review the decision of the United States Court of Appeals for the Fifth Circuit.

Respectfully submitted,

JENKENS & GILCHRIST,
a Professional
Corporation

GREGORY G. HESSE
State Bar No. 09549419

1445 Ross Avenue, Suite 3200
Dallas, Texas 75202
Telephone: (214) 855-4500

Attorneys for Petitioner,
Southmark Corporation

UNITED STATES COURT OF APPEALS
for the Fifth Circuit

No. 94-10774

IN THE MATTER OF: SOUTHMARK CORPORATION,

SOUTHMARK CORPORATION,

Plaintiff-Appellant,

VERSUS

D. VINSON MARLEY,

Defendant-Appellee.

Appeal from the United States District Court
for the Northern District of Texas

ON PETITION FOR REHEARING

(Filed Aug. 8, 1995)

(Opinion June 26, 1995, 5th Cir., 1995, ___ F.3d ___)

Before LAY[1], DUHÉ, and DeMOSS, Circuit Judges.

DUHÉ, Circuit Judge:

We deny Appellant's motion for rehearing, but we vacate our previous opinion, 55 F.3d 1071 (5th Cir. 1995), and substitute the following:

Southmark Corporation, as debtor-in-possession, sought to recover its $400,000 prepetition payment to D. Vinson Marley in an adversary proceeding under Sections

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[1] Circuit Judge, of the Eighth Circuit, sitting by designation.

547 and 548 of the Bankruptcy Code. The bankruptcy court denied recovery after a bench trial. Southmark appealed only the court's ruling on the § 547 preference action. Utilizing clear error review, the district court affirmed. We affirm as well.

BACKGROUND

Southmark and Marley signed an employment contract in 1982 that required Southmark to pay severance benefits in the event it terminated the contract. In 1986, Southmark transferred all its employees to North American Mortgage Investors, Inc. (NAMI), a wholly owned Southmark subsidiary, which in turn leased them back to Southmark. On April 28, 1989, Southmark and Marley executed a settlement agreement, and Marley received a check for $400,000. By signing the agreement, Marley released all Southmark severance obligations under the employment contract ($357,000) and agreed to provide consulting services to Southmark for ninety days hence ($43,000). The check bore NAMI's name and was drawn on Southmark's Payroll Account. The payor bank cleared the check on May 4, 1989.

Southmark filed for a Chapter 11 reorganization in bankruptcy on July 14, 1989, and asserted this action to recover the $400,000 payment to Marley. In its preference cause of action, Southmark alleged that the $357,000 payment of severance benefits was a preference. On cross motions for summary judgment, the bankruptcy court determined that Southmark had satisfied all the elements of a preference except for whether the funds transferred to Marley were property of the estate. In a ruling from the

bench after trial, the court denied the preference. The court held that the transferred funds were not property of the estate because Southmark failed to prove an interest in them. In addition, the court applied the earmarking doctrine to hold that NAMI's payment to Marley, to the extent that it released Southmark's liability to him, merely substituted one creditor for another. As an alternate holding, the court reconsidered its summary judgment ruling and held that the transfer was not a preference because it was not on account of an antecedent debt. Southmark contests the court's three rulings on appeal.

DISCUSSION

While this appeal was pending, we decided *Southmark Corp. v. Grosz*, 49 F.3d 1111 (5th Cir. 1995). Another Southmark preference action, *Grosz* considered whether a Southmark subsidiary's check drawn on Southmark's Payroll Account was property of Southmark's estate. We answered that question in the affirmative. *Id.* at 1119. Consequently, Southmark argues here that Grosz controls the property of the estate issue and requires reversal on that ground. We need not address *Grosz* or the bankruptcy court's application of the earmarking doctrine because we hold that the transfer was not made on account of an antecedent debt.

In its summary judgment ruling, the bankruptcy court held that Southmark established all the § 547(b) elements of a preference with the exception of the property of the estate issue. In its ruling after trial, however,

the court changed its mind. It determined that Southmark's debt arose when it terminated Marley. Considering Marley's termination and the transfer to have been simultaneous, the bankruptcy court concluded that the transfer was not "for or on account of an antecedent debt," which is an element of a preference.[2] The district court saw no error in the bankruptcy court's conclusion.

Southmark challenges the bankruptcy court's conclusion that the debt has not antecedent with three alternative arguments. First, Southmark contends that the debt arose in 1982 when Southmark and Marley executed the employment contract. Second, Southmark contends that it terminated Marley in mid-April 1989, not on April 28. Third, even if the termination occurred on April 28, Southmark argues that the transfer did not occur until May 4, when the drawee bank paid the check.

A debt is antecedent under § 547(b) if the debtor incurs it before making the alleged preferential transfer. *In re Intercontinental Publications*, 131 B.R. 544, 549 (Bankr. D. Conn. 1991); *Tidwell v. AmSouth Bank (In re Cavalier Homes)*, 102 B.R. 878, 885 (Bankr. M.D. Ga. 1989); 4 Lawrence P. King, Collier on Bankruptcy § 547.05 (15th ed. 1995). Our focus, therefore, is on the date the debt was incurred and the date the transfer occurred. The determinations of these dates involve mixed questions of law and fact, which we review de novo. *See Barnhill v. Johnson*, 112 S. Ct. 1386, 1389 (1992).

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[2] "[T]he trustee may avoid any transfer of an interest of the debtor in property . . . for or on account of an antecedent debt owed by the debtor before such transfer was made. . . . " 11 U.S.C. § 547(b) (2) (1988).

Southmark first contends that it incurred its debt when it and Marley signed the employment contract that called for payment of severance benefits in the event of termination. The Code defines "debt" as "liability on a claim." 11 U.S.C. § 101(12) (1988). A debtor incurs a debt when he becomes legally obligated to pay it. *In re Emerald Oil Co.*, 695 F.2d 833, 837 (5th Cir. 1983); *see also Sherman v. First City Bank (In re United Sciences of Am.)*, 893 F.2d 720, 724 (5th Cir. 1990) (explaining, in setoff context, that bank incurred debt when right to payment arose, not when bank asserted right).

Under the Code, a party to an executory contract has a claim against the debtor only when the debtor has rejected the contract. See 11 U.S.C. §§ 365(g), 502(g) (1988); *Wainer v. A.J. Equities*, 984 F.2d 679, 684-85 (5th Cir. 1993) (per curiam). Consequently, a debtor who breaches an executory contract incurs a debt only at the time of breach. *See Wainer*, 984 F.2d at 685. Courts have reached the same conclusion in preference actions. *See In re Energy Coop.*, 832 F.2d 997, 1002 (7th Cir. 1987) (holding that purchaser incurred debt when it anticipatorily repudiated contract to buy crude oil); *In re Gold Coast Seed Co.*, 751 F.2d 1118, 1119 (9th Cir. 1985) (holding that seed buyer became obligated to pay at time of shipment, not when parties executed contract for future shipment).

In *Intercontinental Publications*, the debtor terminated an employee whose employment contract provided for severance benefits payable in installments after termination. The debtor brought a preference action, and the bankruptcy court considered whether the installment payments were on account of an antecedent debt. The court held that the debtor incurred its debt when the

debtor terminated its employee. 131 B.R. at 550. Likewise, we conclude that Southmark incurred its debt to Marley at the time it terminated him.

The bankruptcy court found that Marley's termination occurred simultaneously with the execution of the settlement agreement. We review a bankruptcy court's factual findings for clear error, and we adhere strictly to that standard of review when the district court has affirmed those findings. *In re Young*, 995 F.2d 547, 548 (5th cir. 1993). Southmark contends that Marley was terminated in mid-April 1989, before the parties executed the settlement agreement on April 28. As sole support of its contention, Southmark cites the deposition of its Chief Executive Officer, Arthur G. Weiss. Weiss's deposition testimony, however, does not support Southmark's contention; instead, Weiss explained that the settlement agreement provided payment to Marley in termination of the employment contract. The bankruptcy court's finding is not clearly erroneous.

Finally, Southmark contends, even if it incurred the debt on April 28, that the transfer occurred on May 4 when the bank paid on the check. Southmark cites *Barnhill* for the proposition that a transfer by check occurs, for purposes of § 547(b), on the date of honor, not the date of delivery. 112 S. Ct. at 1391. Because *Barnhill* makes the date of transfer later than the date Southmark incurred the debt, Southmark contends that the transfer was on account of an antecedent debt. We disagree.

State law governs the rights and duties of parties to a check transaction. *Id.* at 1389. *Barnhill* recognizes that the obligee's receipt of a check suspends the underlying

obligation so long as the check is presented to the drawee bank within a reasonable time. *Id.* (citing U.C.C. § 3-802(1) (b) (1991)); *In re Child World*, 173 B.R. 473, 477 & n.3 (Bankr. S.D.N.Y. 1994). Consequently, if the debtor delivers a check before incurring a debt, the transfer is not made on account of an antecedent debt because the underlying obligation is suspended until the check clears. *Child World*, 173 B.R. at 477.[3]

In this case, Marley received his check simultaneously with his termination. His taking of the check suspended Southmark's simultaneous obligation to pay his severance benefits until the check was presented to the drawee bank. When the transfer occurred at the time of honor, Southmark's simultaneous obligation was discharged. The transfer, therefore, was on account of a simultaneous debt, not an antecedent debt.

CONCLUSION

For the foregoing reasons, the district court's judgment affirming the bankruptcy court is AFFIRMED.

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[3] The issue in *Barnhill* was whether the check transfer came within the 90 day preference period of § 547(b) (4). Because the date of honor rule allows the trustee to test more transfers as preferences, that rule furthers the bankruptcy goal of distributive equality among creditors. *Child World*, 173 B.R. at 477 n.2. In contrast, treating check payments of simultaneous debts as antecedent debt transfers potentially offers other creditors a windfall at the expense of the check holder because he has offered current consideration for the check. *Id.* at 477 & n.2.

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 94-10774

In The Matter of: SOUTHMARK CORPORATION

Debtor

SOUTHMARK CORPORATION

Appellant

v.

D VINSON MARLEY

Appellee

Appeal from the United States District Court for the Northern District of Texas, Dallas

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ON PETITION FOR REHEARING

(August 30, 1995)

Before *LAY, DUHÉ and DeMOSS, Circuit Judges.

PER CURIAM:

IT IS ORDERED that the petition for rehearing filed in the above case is DENIED.

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* Circuit Judge, of the Eighth Circuit, sitting by designation.

ENTERED FOR THE COURT:

/s/ Duhe
United States Circuit Judge

REHG-2

CLERK'S NOTE:
SEE FRAP AND LOCAL RULES 41 FOR STAY OF THE MANDATE.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE: SOUTHMARK CORPORATION, Debtor.	BANKRUPTCY CASE NO. 389-36324-SAF-11
SOUTHMARK CORPORATION, Appellant, VS. D. VINSON MARLEY, Appellee.	CIVIL ACTION NO. 3:93-CV-1648-G

JUDGMENT

(Filed July 25, 1994)

This case was submitted on the record and briefs on appeal. Upon consideration whereof, it is **ORDERED** that the order of the bankruptcy court is **AFFIRMED.**

July 25, 1994.

/s/ A. Joe Fish
A. JOE FISH
United States District Judge

Certified a true copy of an instrument on file in my office on 9/7/94 NANCY HALL DOHERTY, Clerk, U.S. District Court
Northern District of Texas
By /s/ Illegible Deputy

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE: SOUTHMARK CORPORATION, Debtor.	BANKRUPTCY CASE NO. 3389-36324-SAF-11
SOUTHMARK CORPORATION, Appellant, VS. D. VINSON MARLEY, Appellee.	CIVIL ACTION NO. 3:93-CV-1648-G

MEMORANDUM ORDER

(Filed July 25, 1994)

Before the court is the appeal of Southmark Corporation ("Southmark") from a final order of the bankruptcy court. After due consideration, and for the reasons stated below, the order of the bankruptcy court is affirmed.

I. BACKGROUND

Before Southmark filed for bankruptcy, D. Vinson Marley ("Marley") worked as a Senior Executive Vice President of Southmark under an employment agreement dated August 16, 1982. Marley's paychecks, however, were written by North American Mortgage Investors, Inc. ("NAMI"), a Southmark subsidiary, from which Marley's services were leased. In mid-April 1989, Marley was terminated by Southmark. On April 28, 1989, Marley

received a final check from NAMI in the amount of $400,000 ("the transfer") in full satisfaction of the employer's severance obligations under the employment agreement and as a prepayment for consulting services from April 30, 1989 through July 31, 1989. The check was paid by San Jacinto Savings Association ("San Jacinto") on May 4, 1989.

On July 14, 1989, Southmark filed its voluntary petition for relief under Chapter 11 of Title 11 of the United States Code ("the Bankruptcy Code"), such bankruptcy case styled *In re Southmark Corporation*, No. 389-36324-SAF-11. Southmark later initiated an adversary proceeding in the bankruptcy court styled *Southmark Corporation v. D. Vinson Marley*, Adversary Proceeding No. 391-3365 ("the adversary proceeding"), to recover the transfer as a preference and/or fraudulent transfer.

On January 22, 1993, Southmark and Marley each filed motions for summary judgment. On February 25, 1993, the bankruptcy court conducted a hearing on the motions for summary judgment, and pronounced judgment in Southmark's favor on all elements of its claim that the transfer was recoverable as a preference except for the issue of whether Southmark owned an interest in the funds transferred to Marley. The court further pronounced judgment in Southmark's favor as to (1) the contemporaneous exchange defense of § 547(c) under the Bankruptcy Code; (2) the ordinary course of business defense under § 547(c)(2) of the Bankruptcy Code; and (3) all of the counterclaims raised by Marley in his answer. The court also denied both motions for summary judgment as to (1) the fraudulent transfer claim under § 548 of the Bankruptcy Code and (2) the subsequent new value

defense under § 547(d)(4). A partial summary judgment reflecting these rulings was entered by the bankruptcy court on March 30, 1993.

On June 22 and 23, 1993, the bankruptcy court conducted a bench trial on the issues left unresolved in the adversary proceeding by the partial summary judgment. At the end of the trial, the bankruptcy court granted judgment in favor of Marley, holding that the transfer was not a "transfer of an interest of the debtor [i.e., Southmark] in property" as required by §§ 547(b) and 548(a) of the Bankruptcy Code. The bankruptcy court also "questioned" in its ruling whether it had correctly decided in the partial summary judgment that the preferential transfer was made on account of an antecedent debt owned by Southmark to Marley, as required by § 547(b)(2) of the Bankruptcy Code.

On July 14, 1993, judgment in Marley's favor was entered by the bankruptcy court. This appeal followed.

II. QUESTIONS PRESENTED

The questions presented on this appeal are:

a. Whether the bankruptcy court erred in concluding that the transfer to Marley was not a transfer of an interest of Southmark in property pursuant to 11 U.S.C. §§ 547(b);

b. Whether the bankruptcy court erred in concluding that the burden of proof as to the ear-marking doctrine lies with Southmark;

c. Whether the bankruptcy court erred in concluding that Marley established the elements necessary for the ear-marking doctrine;

d. Whether the bankruptcy court erred in concluding that the cash management system was designed solely for Southmark's subsidiaries;

e. Whether the bankruptcy court erred in concluding that all money in account number 538001448 at San Jacinto was managed by Southmark solely for its subsidiaries; and

f. Whether the bankruptcy court erred in concluding that the transfer to Marley was not on account of an antecedent debt pursuant to 11 U.S.C. § 547(b).

III. ANALYSIS

A. Did the Bankruptcy Court Err in Finding that Southmark Had No Interest in the Transferred Funds?

The threshold and dispositive question on this appeal is whether the bankruptcy court erred in finding that Southmark lacked any interest in the $400,000 transferred to Marley. Under 11 U.S.C. § 547(b), "the trustee may avoid [as a preference] any transfer of an interest of the debtor in property . . . ". A finding that Southmark had an interest in the $400,000 is thus an essential element for avoidance of the transfer by the trustee under this provision.

After the bankruptcy court granted partial summary judgment to Southmark, the only question of fact remaining was whether Southmark, at the time Marley received this $400,000 payment, had an interest in those funds. The bankruptcy court found at trial that Marley was an employee of NAMI at the time of the transfer and that all

of the funds paid to Marley belonged to NAMI, so that Southmark had no interest in the transferred funds.

This court reviews these factual findings under the clearly erroneous standard. *Matter of Luce,* F.2d 1277, 1280 (5th Cir. 1992). The bankruptcy court has considerable experience and expertise in resolving disputes involving financial matters, and this court must apply the clearly erroneous standard even when the bankruptcy court's findings of fact "do not rest on credibility determinations, but are based instead on physical or documentary evidence or inferences from other facts." *Anderson v. City of Bessemer City, North Carolina,* 470 U.S. 564, 574 (1985).

After a careful review of the record, the court cannot say that the bankruptcy court was in error at all, much less clearly erroneous, in making these findings. There is ample evidence from which the bankruptcy court could find that Marley was employed by NAMI and that the transferred funds were owned by NAMI and other subsidiaries on the day of the transfer. Southmark's appeal on this point therefore lacks merit.

B. Other Points on Appeal

Since Southmark has failed to prove a *prima facie* case of a voidable transfer under §§ 547(b), it is unnecessary to decide Southmark's remaining contentions. For the sake of completeness, however, the court will briefly notice these other points. Southmark asserts that the bankruptcy court erred (1) in its placement to the burden of proof on the ear-marking doctrine and (2) in its factual findings on Marley's establishment of the ear-marking defense, the

design of Southmark's cash management system, the nature and use of the money in account number 538001448 at San Jacinto Savings Association, and on the question of whether these funds were paid to Marley on account of an antecedent debt. The court is not persuaded that Southmark has shown error by the bankruptcy court on any of these points.*

IV. CONCLUSION

For the reasons stated, the order of the bankruptcy court is **AFFIRMED.**

SO ORDERED.

July 25, 1994.

/s/ A. Joe Fish
A. Joe Fish
United States District Judge

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*Even if the bankruptcy court did err in any of these respects, however, such error was necessarily harmless because the finding that Southmark did not have an interest in the $400,000 is dispositive and renders all other questions on this appeal immaterial.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	§	
SOUTHMARK CORPORATION,	§	CASE NO. 389-36324-SAF-11
DEBTOR.	§	(Filed Jul. 14, 1993)
	§	ADVERSARY NO. 391-3365
SOUTHMARK CORPORATION,	§	
Plaintiff,	§	
V.	§	
D. VINSON MARLEY,	§	
Defendant.	§	

JUDGEMENT

On June 22, and June 23, 1993 came on for trial the above captioned adversary proceeding. After consideration of the evidence, testimony of the witnesses at trial, and argument of counsel, the Partial Summary Judgment entered on March 30, 1993 and consistent with the attached findings of fact and conclusions of law, the Court is of the opinion that judgement should be entered in favor of D. Vinson Marley; it is therefore

ORDERED that judgment is hereby entered in favor of D. Vinson Marley and dismissing him from all causes of action alleged in this adversary proceeding by Southmark with prejudice to refiling; and it is further

ORDERED that judgment is hereby entered in favor of Southmark Corporation dismissing it from all causes of action alleged in this adversary proceeding by D. Vinson Marley with prejudice to refiling; and it is further

ORDERED that any relief not expressly granted herein is denied.

DATED this 13th day of July, 1993.

/s/ Steven A. Felsenthal
Steven A. Felsenthal,
United States Bankruptcy
Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	)	
	)	BK. NO. 389-36324-SAF-11
SOUTHMARK	)	
CORPORATION	)	

D. VINSON MARLEY	)	ADV. NO. 391-3365

* * *

TRANSCRIPT OF PROCEEDINGS

* * *

COURT'S RULING

BE IT REMEMBERED that on the 29th day of June, 1993, before the HONORABLE STEVEN FELSENTHAL, United States Bankruptcy Judge at Dallas, Texas, the above-styled and numbered cause came on for hearing, and the following constitutes the transcript of such proceedings as set forth hereinafter:

[p. 2] APPEARANCES

JENKENS & GILCHRIST
1445 Ross Avenue
Suite 3200
Dallas, Texas 75202
By: Mr. Gregory Hess

FOR SOUTHMARK
CORPORATION

ROSA ORENSTEIN, P.C.
3500 Oak Lawn
Suite 750
Dallas, Texas 75219
By: Ms. Rosa Orenstein

FOR D. VINSON MARLEY

[p. 3] PROCEEDINGS

THE COURT: In adversary number 391-3365 I'll take appearances, please.

MR. HESSE: Good morning, Your Honor. Greg Hesse and Jack Bird on behalf of Southmark Corporation.

MS. ORENSTEIN: Rosa Orenstein on behalf of D. Vinson Marley.

THE COURT: Thank you.

The Court has asked you to return this morning so I could give a bench ruling on the adversary proceeding. It turns out that these findings are longer than I anticipated, but it's still more expeditious to do it this way.

On June 22 and June 23, 1993, the Court conducted a trial on issues remaining in this adversary proceeding after the Court's earlier summary judgment ruling.

This will be the Court's findings of fact and conclusions of law, and the Court reserves the right to edit, supplement or amend these findings prior to the entry of a final judgment.

An adversary proceeding to avoid transfer under Sections 547 and 548 of the Bankruptcy Code are core

matters over which this Court has jurisdiction to enter final judgment.

[p. 4] On April 28, 1989, the defendant, Mr. Marley, received $400,000 on a check in the name of North American Mortgage Investors, known as NAMI, drawn on a Southmark account number 2909 at San Jacinto Savings Association. Southmark seeks to avoid and recover that transfer under either Sections 547 or 548, or a combination.

Under both statutes, the transfer must be "of an interest of the debtor". Southmark contends that it had an interest in the funds transferred to Mr. Marley. Mr. Marley contests that assertion. Southmark has the burden of proof.

On April 28, 1989, account 2909 was in Southmark's name. It was a payroll account funded from account 1448, another San Jacinto Savings account in Southmark's name. Southmark operated account 1448 as a corporate cash concentration account. NAMI was a wholly owned Southmark subsidiary. Southmark was a holding company. Southmark contends that deposits in a bank account in Southmark's name belong to Southmark, citing a series of cases including Meade Collins Securities, Pimental and Homan.

Those cases analyze property interest of the bankruptcy estate under Section 541 of the Bankruptcy Code and establish the proposition that unless a bank [p. 5] account is expressly established as something different such as a trust account or a reserve account, the account is regarded as property of the estate.

The Court must analyze the evidence in a particular case according to the teachings of these cases to determine the nature of the account.

The issue in this case, however, is not whether the accounts became property of the estate, but whether Southmark had an interest in the deposits in the accounts for the period of April 28, 1989 to May 4, 1989.

Nevertheless, the Court analyses the evidence based on this proposition of law since an interest in property for purposes of Section 541 should apply throughout Chapter 5 of the Bankruptcy Code.

Southmark operated account 1448 as part of the cash management system established by Mr. Marley when he served as Southmark's executive vice president and CFO. Southmark established the cash management system to concentrate excess cash for its various subsidiaries and affiliates in the centralized system to maximize investment opportunities until the cash was needed by the respective entities.

Southmark controlled the use of the funds deposited into the concentration account. Mr. Marley testified that Southmark never intended to own the funds, rather, [p. 6] the funds belonged to the subsidiaries and the affiliates managed by Southmark as the parent corporation to maximize the return to the subsidiaries and corresponding enhancement of Southmark's equity in the subsidiaries.

Mr. Galecke, Southmark's treasurer in 1989, testified that Southmark controlled access to the funds once deposited in account 1448 without any restriction placed on the funds by the subsidiaries. Mr. Hair, Southmark's

CFO in 1989, testified that once the funds had been transferred into the concentration account, Southmark intended for the deposits to be Southmark's with credit to the subsidiaries or debited to Southmark and various inter-company accounts.

The $400,000 transferred to Mr. Marley from account 2909 came from account 1448. If Southmark had an interest in the funds on deposit in 1448 on April 28, 1989, to the May 4, 1989 period, then Southmark had an interest in the funds transferred to Mr. Marley.

Southmark's officers also served as officers of the various subsidiaries participating in the concentration account. Southmark's officers could not declare dividends by the subsidiaries to be paid to Southmark as an equity holder and could not pay debts owed by the subsidiaries, if any, to Southmark. As Southmark officers, they could only perform Southmark's function [p. 7] consistent with the corporate relationships between Southmark and its subsidiaries.

By exercising control over the concentration account, Southmark's officers were performing the cash management service for the subsidiaries. Southmark did not obtain an ownership interest in the deposits by performing that function. Rather, as a matter of law, the funds were transferred as a matter of corporate law by the officers acting with the respective subsidiary corporate hat, and then in effect placing on their Southmark hat for the purpose of managing the cash.

As Mr. Marley testified and Mr. Marley created this system, Mr. Galecke was the subsidiaries' corporate treasurer, and would wear that corporate hat to accomplish the transfer with Southmark only managing the funds.

This evidence suggests that this type of concentration account may not be the type of bank account that becomes property of the estate under the case law that the parties have cited. Indeed, after the filing of the bankruptcy petition, the Court held a series of hearings regarding the cash management system.

The Court, with the consent of Southmark and its subsidiaries and after notice and hearing, directed the manner of cash management, an exercise that may have been [p. 8] unnecessary if indeed the account belonged to Southmark and was being managed by the insiders of Southmark. The very uncertainty of the relations compelled that the system be operated post-petition only by Court order.

Against this background and on this evidence, the Court concludes that Southmark has not met its burden of proof. Although that conclusion is dispositive, the Court must address the other issues raised.

Under the analysis of whether Southmark had an interest in the property transferred, the Court must apply the teachings of the Fifth Circuit in Coral Petroleum. If the transfer resulted in the substituting of one creditor for another, no preference occurred.

On April 28, 1989, account 1448 had approximately a $200 balance. On April 27, 1989, NAMI transferred $475,000 into account 1448. On April 28, 1989, Southmark

caused $655,000 to be transferred from account 1448 to account 2909 to be used for the payroll of Southmark subsidiaries. On April 28, 1989, other deposits were made by subsidiaries into account 1448.

Neither Mr. Galecke, the Southmark treasurer, nor Mr. Hair, the Southmark CFO, could identify the specific reason for the deposits or explain the entries. Mr. Galecke testified that the account included dividends paid to Southmark and loans made by Southmark repaid by [p. 9] subsidiaries, but neither he nor Mr. Hair could identify a single such entry and neither could identify or testify that the deposits as of April 28, 1989 included dividends or loan payments that would have been Southmark's property.

Southmark, accordingly, did not meet its burden of proof that Southmark funds were deposited into the account in the relevant time. Had Southmark funds been deposited, there would have been a commingling with all of the other cash in the account, and thereby an interest in the property would have been transferred to 2909, but here there is no evidence that indeed on April 28, 1989, any Southmark funds were in that account.

The Court infers from this lack of evidence that on the close of business on April 28, 1989, account 1448 only had funds belonging to NAMI and other Southmark subsidiaries. NAMI issued the $400,000 check to Marley on April 28, 1989 from the 2909 payroll account.

Southmark caused funds to be transferred from account 1448 to account 2909 on May 1, 1989 to cover that check. Marley was paid by funds of NAMI and/or other subsidiaries. The subsidiaries deposited the funds in the

concentration account for investment purposes to be drawn when necessary to pay the subsidiaries' bills.

Marley was a NAMI employee. NAMI used these funds [p. 10] to pay the Marley obligation. To the extent that Southmark had liability as well as NAMI because Southmark actually negotiated and entered the separation agreement, one creditor or group of creditors, NAMI or the other subsidiaries, was substituted for another creditor, Marley, thereby precluding a preference under Coral Petroleum.

Further, NAMI actually paid a NAMI debt with its or its subsidiaries' funds. In 1984 Southmark hired Mr. Marley. But in 1986 Southmark transferred its employees to NAMI using the employees under an employee leasing-type system. Southmark made this move for tax purposes.

Mr. Marley, Mr. Galecke and Mr. Hair all were NAMI employees. They all received W-2 statements reflecting that fact. NAMI issued their paychecks. Southmark's bankruptcy schedules, sworn under oath by Mr. Hair, reflected that Southmark had no employees. Mr. Marley testified that the failure to transfer account 2909, the payroll account, to NAMI until June of 1989, was an oversight. The account should have belonged to NAMI.

All this evidence is consistent with Southmark's sworn representations to this Court, to the IRS and to the State of Texas.

The check issued to Marley says it's from NAMI. The [p. 11] check was signed by Mr. Galecke who was NAMI's treasurer. Although NAMI employees, Mr. Galecke, Mr.

Hair and Mr. Marley all felt they worked for Southmark, but indeed they demonstrated that Southmark was a holding company and that by working for Southmark, they were testifying that they worked for the Southmark corporate family.

In this process, Southmark has only shown that it had managed funds for its subsidiaries. Payment of a NAMI payroll obligation with NAMI or other subsidiary funds does not constitute a payment by Southmark with its interest in property, even though the NAMI payment also satisfies Southmark's obligation under the separation agreement.

Southmark created this corporate structure. Throughout the underlying bankruptcy case and the many adversary proceedings that have been filed in this case this Court has required that Southmark and all interested parties adhere to the corporate entities and respective rights and obligations unless a party with standing established the relative criteria to pierce the respective corporate veils. Southmark cannot do that.

Because Southmark has failed to meet its burden of proof that a transfer of an interest in the debtor and property occurred, Mr. Marley is entitled to a judgment [p. 12] dismissing both 547 and 548 causes of action.

Again, for complete findings, the Court finds under Section 547 that Mr. Marley was paid for his pre-petition post-transfer consulting services. Therefore, he cannot reduce his preference exposure, if any, under Section 547(c)(4).

In the summary judgment ruling, the Court found that no genuine issue of material fact existed concerning elements of Section 547(b). The parties and the Court assumed at the summary judgment hearing that the transfer had been on account of an antecedent debt owed.

The parties renewed the assumption after questioning by the Court during closing argument, but in light of recent decisions made by this Court in other Southmark adversaries, the Court now questions that assumption.

Southmark entered a contract with Mr. Marley that provided for certain separation benefits in the event of a termination. The contract was entered well before the transfer. Also before the transfer, NAMI became the employer. A debt includes a contingent liability. The liability was not owed until the termination occurred. The transfer and termination constituted a simultaneous event; therefore, the Court now questions whether the transfer was made on account of an antecedent debt owed, meaning before the transfer. That is the essence of a [p. 13] preference.

As the Fifth Circuit has just recognized in another Southmark avoidance action, Section 547 must be read as a whole giving effect to all its provisions.

Under Section 548, payment of the antecedent debt arising from the contract constituted value as a matter of statutory definition.

Under its agreement with Southmark, Mr. Marley provided three months' of what has been called consulting services. Mr. Weiss, as the Southmark CEO, requested

that Mr. Marley take all steps necessary during those 90 days to assure a smooth transition.

The evidence actually establishes that his consulting fee was for transition services. Mr. Hair testified that Mr. Marley remained at Southmark through at least May and June. Mr. Marley testified about the activities he performed up to the petition date.

In addition, Mr. Marley's agreement provided for $150. per hour fee after the 90 days for his time relating to litigation. He has been required to submit to at least 10 depositions for one to five days each, and spend other time related to litigation for which he has not been paid by Southmark pursuant to the agreement.

Considering the transition services performed during the 90 days, Southmark has not met its burden of proof [p. 14] that it did not receive reasonably equivalent value for the consulting fee paid.

I believe that covers all the issues. The Court would ask Ms. Orenstein to prepare an order dismissing the complaint.

MS. ORENSTEIN: We will do that. I would request a copy of the transcript, make sure I get everything.

THE COURT: You need not repeat it all, just refer the Court made dispositive findings and address the findings and conclusions for the other issues for completeness purposes so that these findings can be read with the summary judgment for all of the issues in the case, then just reference those.

MR. HESSE: I would just like an opportunity to review it in advance.

MS. ORENSTEIN: Thank you, Your Honor.

THE COURT: Thank you.

MR. HESSE: Thank you, Your Honor.

(End of Court's ruling.)

CERTIFICATE

I, VICKI K. KANEWSKE, Acting Official Court Reporter in and for the United States Bankruptcy Court for the Northern District of Texas, Dallas Division, certify that during the hearing of the above entitled and numbered cause I reported in shorthand the proceedings, hereinafter set forth, and that the foregoing pages contain a full, true and correct transcript of said proceedings.

GIVEN UNDER MY HAND AND SEAL OF OFFICE on this the 2nd day of July, 1993.

/s/ Vicki K. Kanewske
VICKI K. KANEWSKE
Certified Shorthand Reporter
#2159
Acting Official Court Reporter
United States Bankruptcy Court
Northern District of Texas
Dallas Division

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	§	
SOUTHMARK CORPORATION,	§	CASE NO.
	§	389-36324-SAF-11
DEBTOR.	§	
	§	
SOUTHMARK CORPORATION,	§	
Plaintiff,	§	
vs.	§	ADVERSARY NO.
	§	391-3365
D. VINSON MARLEY,	§	
Defendant.	§	

PARTIAL SUMMARY JUDGMENT

CAME ON before the undersigned United States Bankruptcy Judge on the 25th day of February 1993 to consider the Motion of Southmark Corporation for Summary Judgment (the "Southmark Motion") filed herein by Southmark Corporation ("Southmark"), and the Motion for Summary Judgment (the "Marley Motion") filed herein by D. Vinson Marley (the "Defendant"). Appearing on behalf of Southmark was Gregory G. Hesse of the law firm of Jenkens & Gilchrist, a professional corporation. Appearing on behalf of the Defendant was Rosa R. Orenstein of the law firm Rosa R. Orenstein, p.c. After considering the pleadings, and the arguments of counsel, the court is of the opinion that the Southmark Motion should be granted in part and denied in part, and that the Marley Motion should be denied. Accordingly it is therefore

ORDERED that the Southmark Motion and the Marley Motion are both denied and the court will conduct an evidentiary trial on the issue of whether or not Southmark owned an interest in the $400,000 (the "Transfer") transferred to Defendant. It is further

ORDERED that the Southmark Motion is granted and the Marley Motion is denied and judgment in favor of Southmark is granted as to the prima facie elements 11 U.S.C. § 547(b) (with the exception of the property interest of Southmark in the transfer) as to $357,000 of the Transfer (the "Preferential Transfer"). It is further

ORDERED that the Southmark Motion is granted and judgment in favor of Southmark is granted as to the contemporaneous exchange defense of 11 U.S.C. § 547(c)(1) as to the Preferential Transfer. It is further

ORDERED that the Southmark Motion is granted and judgment in favor of Southmark is granted as to the ordinary course of business defense of 11 U.S.C. § 547(c)(2). It is further

ORDERED that the Southmark Motion is denied and the court shall conduct an evidentiary trial as to the subsequent new value defense of 11 U.S.C. § 547(c)(4). It is further

ORDERED that the Southmark Motion and the Marley Motion are denied and the court shall conduct an evidentiary trial as to the fraudulent transfer cause of action under 11 U.S.C. § 548 on the Transfer. It is further

ORDERED that the Southmark Motion is granted and judgment in favor of Southmark is granted as to all of the Defendant's counter-claims.

SIGNED this ___ day of _____, 1993.

MAR 26 1993

ORIGINAL SIGNED BY
/s/ STEVEN A. PELSENTHAL
STEVEN A. FELSENTHAL,
UNITED STATES
BANKRUPTCY JUDGE

After entry, please return to

Gregory G. Hesse
Jenkens & Gilchrist,
a professional corporation
1445 Ross Avenue Suite 3200
Dallas, Texas 75202